VZCZCXRO2904
RR RUEHBZ RUEHDU RUEHJO RUEHMR RUEHRN
DE RUEHSA #2257/01 1730918
ZNR UUUUU ZZH
R 220918Z JUN 07
FM AMEMBASSY PRETORIA
TO RUEHC/SECSTATE WASHDC 0509
RUCNSAD/SOUTHERN AF DEVELOPMENT COMMUNITY COLLECTIVE
RUCPCIM/CIMS NTDB WASHDC
RUCPDC/DEPT OF COMMERCE WASHDC
RUEATRS/DEPARTMENT OF TREASURY WASHDC
RUEHJO/AMCONSUL JOHANNESBURG 7009
RUEHTN/AMCONSUL CAPE TOWN 4548
RUEHDU/AMCONSUL DURBAN 8960

UNCLAS SECTION 01 OF 03 PRETORIA 002257

SIPDIS

DEPT FOR AF/S/MTABLER-STONE; AF/EPS; EB/IFD/OMA
USDOC FOR 4510/ITA/MAC/AME/OA/DIEMOND
TREASURY FOR OAISA/RALYEA/CUSHMAN
USTR FOR COLEMAN

SIPDIS

E.O. 12958: N/A
TAGS: ECON EFIN EINV ETRD EMIN EPET ENRG BEXP KTDB SENV
PGOV, SF
SUBJECT: SOUTH AFRICA ECONOMIC NEWS WEEKLY NEWSLETTER JUNE 22, 2007
ISSUE

PRETORIA 00002257 001.2 OF 003

¶1. (U) Summary. This is Volume 7, issue 25 of U.S. Embassy Pretoria's South Africa Economic News Weekly Newsletter.

Topics of this week's newsletter are:
- SA Economy With Capacity Problems
- Rate Hikes 'Filtering Through To Economy'
- Warning For SA Trade
- Labor Holds SA Back
- New ANC leader 'Will Affect Credit Rating'
End Summary.

SA Economy With Capacity Problems

¶2. (U) According to ABSA Chief Economist Christo Lu|s, the South African economy appears to be suffering from an element of dysfunction, with capacity limitations becoming endemic. "This is exacerbating the large deficit on the current account of the balance of payments. In addition, business confidence is reportedly being affected because of the increasing bottlenecks," Lu|s said. Most periods of South African economic growth since 1945 have been brought to an end by three factors: balance of payments problems, inflation and a shortage of skilled labor. He holds economic structural changes, including emigration, the HIV/Aids pandemic and an ineffective educational system responsible for the shortages of the appropriate and requisite skills. "A current paradox of the South African economy is that millions of unskilled people are unemployed, but there are acute shortages of skilled people at the same time." According to Lu|s, similar shortages are being replicated in other areas of the economy, like ship repair and oil rig maintenance sectors, the gas and glass industries, electricity supply, cement, bricks, newsprint, fertilizers, soft drinks, milk, etc. During the last quarter of 2006, major supermarket groups made references to shortages developing in the supply of certain grocery products, including toiletries and food. "There are also infrastructural bottlenecks in areas such as roads, rail links, ports and airports, and the state of many of the existing infrastructural facilities is poor, said Lu|s. Lu|s believes that a supply-side crisis is plaguing the domestic economy and the shortages being experienced are connected to the acceleration of economic growth in recent years after a lean period in the 1980s and 1990s. "The faster growth is primarily attributable to the

unprecedented boom in international commodity prices, which started in September 2001 and has proved to be far more sustainable than was generally anticipated." He said that faster growth has caused a steep increase in capacity utilization rates in the economy, while the capital stock as a ratio of GDP has declined, from 247% in 1992 to 193% last year. Lu|s proposes policy options which would alleviate and over time eliminate the various capacity constraints in the economy. These include achieving more deregulation in the labor and capital markets, the abolition of exchange controls, an improvement in the education system, retention of the existing skills, effective measures to bring crime under control, and lowering the tax and compliance burden on individuals and companies. (Business Day, June 14, 2007)

Rate Hikes 'Filtering Through To Economy'

¶3. (U) Retail sales growth slowed to its lowest pace in 19 months, from a seasonally adjusted 10.5% in March to 4.2% in April, suggesting that higher interest rate hikes have begun to curb consumer spending, and making another rise in lending rates this year look a bit less likely. After news that car sales decreased in April and May, the data reinforced evidence that the South African Reserve Bank's (SARB's) decision to raise lending rates by two percentage points in the second half of last year was starting to dampen consumer demand, which has been the main engine of economic growth as well as a factor behind rising inflation. It normally takes six to 12 months for consumers to respond to changes in lending rates, and when the Reserve Bank hiked its key repo rate again two week ago, SARB Governor Tito Mboweni acknowledged that the effect of last year's increases had not yet been fully felt in the economy. But with inflation set to remain above the upper end of its 3%-6% target range until the second quarter of next year, it will take more than a slowdown in retail spending to persuade the Bank not to raise rates again at its next policy meeting in August.

(Business Day, June 14, 2007)

Warning For SA Trade

¶4. (U) According to the Absa/Sacob Trade Activity Index, South Africa's trade conditions improved from 50 points in April to 54 points in May but were still below levels seen earlier this year. In May 2006 the Index was at 59.2. Nearly all the sub-indices of the Index improved during May 2007, except for the price and employment indicators, which remained unchanged from April. Relatively buoyant trade conditions over the short term were supported by new orders, backlogs on orders received, and supplier deliveries as well as improved inventory levels. SA Chamber of Business (Sacob) economist Richard Downing commented: "The introduction of the National Credit Act on June 1, the higher interest rate announced in early June 2007 and the interest rate increases during 2006 may eventually not only constrain lending, but also hamper trade conditions." (Fin24, June 13, 2007)

Labor Holds SA Back

¶5. (U) According to the Africa Competitiveness Report 2007, South Africa ranked the 46th most competitive country in the world out of 128 economies and the second-ranked country in Africa. That is six places lower than its 2005 ranking when it was ranked 40th out of 117 economies. The study forms part of the Global Competitiveness Report (GCR), a joint study conducted by the World Economic Forum, the African Development Bank and the World Bank. According to the report, South Africa ranks 126th in terms of labor market flexibility, which encompasses ease of hiring and firing, flexibility of wage determination and union-employer relations. According to John Page, Chief Economist for Africa and the Director of the Poverty Reduction Group at the World Bank in Washington DC, a lack of skills would also continue to hobble the competitiveness of

Africa's biggest economy. "Skills are beginning to constrain the competitiveness of countries like Mauritius and South Africa, which have relatively high levels of manufacturing intensity," said Page. South Africa's higher education and training ranking also dropped to 57th place overall from 47th place last year. Although South Africa prides itself as having arguably the most sophisticated infrastructure in Africa, the country also saw its ranking for this variable drop to 50th place from its previous ranking of 35th. The report listed "particular concerns about the quality of electricity supply that has been increasingly plagued by interruptions and the low penetration rate of telephone lines". The report also listed "a lack of security" as an obstacle to doing business in South Africa. "The business cost of crime and violence (116th) and the unreliability of police services to protect citizens from crime (92nd) are highlighted as particular concerns," said the report. However, South Africa did perform well on some fronts, achieving a high ranking for property rights (23rd), corporate ethics (30th) as well as financial market efficiency (27th), business sophistication (32nd) and innovation. "South Africa's scientific research institutions are assessed as on par with Hong Kong's and the country has a higher rate of patenting than a number of European countries including Greece, Portugal and Russia. South Africa accounts for a third of sub-Saharan Africa's GDP despite having only 6% of its population. South Africa's GDP is estimated at $255.2 billion and industrial production contributes 20.9% to the economy with services accounting for 66.4%. (Fin24, June 13, 2007)

New ANC leader 'Will Affect Credit Rating'

¶6. (U) According to Moody's Investor Service, South Africa was unlikely to receive an expected sovereign rating upgrade before the African National Congress (ANC) chose a new leader in December, as investors wanted reassurance that the country's prudent economic policies would remain in place. The US ratings agency revised its outlook on South Africa's Baa1 mid-investment grade rating for foreign currency debt from "stable" to "positive," based on South Africa's improved external liquidity position as well as external credit ratios which compared favorably with many of its rating peers. Moreover, South Africa's foreign debt as percentage of total

debt had fallen from 17.6% in 2002 to the current 14%, much lower than a median of 36.6% for countries rated Baa1. Moody Senior Credit Officer Kristin Lindow told a conference organized by the agency that the public debate about the new leader of the ANC who is likely to succeed President Thabo Mbeki in 2009 had slowed to its lowest pace in 19 months and was "finally on the radar screens" of the global investor community. Investors want a candidate who would stick to existing economic policy and build consensus in the ANC while supporting its political agenda. Nearly all of the factors which could lower South Africa's rating involved possible policy changes, such as tampering with the rand's floating exchange rate, populist spending which would boost public and foreign debt, and political instability which could threaten its solid economic framework. (Business Day, June 15, 2007)

BOST